

SECTION 3

INDICES

3.1 INTRODUCTION

The Commission's Price Cap Plan requires Bell Atlantic to compute the appropriate adjustments to the PCI and API for each service basket, and to calculate SBI values for individual service categories.^{12/} The exogenous cost changes, demand, and rates used in the computation of such indices are described in Sections 3, 4, and 5 of this filing. The computations of the indices can be found in Section 6, Workpapers 6-1 through 6-4 and 6-7 through 6-9.

In this filing the PCIs, APIs, and SBIs proposed in Bell Atlantic Transmittal No. 492, filed February 18, 1992, to be effective March 3, 1992, will represent the period t-1 for Common Line, Switched Access, Special Access, and Interexchange.

12. See 47 C.F.R., Sections 61.45, 61.46 (a), and 61.47 (a) and (e).

3.2 COMPUTATION OF INDICES

Bell Atlantic applied the formula prescribed in Section 61.45 of the Commission's Rules to compute the PCI for the Common Line, Switched Access, Special Access, and Interexchange baskets under the proposed March 3, 1992 rates. Results of PCI computations for each basket are displayed in Figures 3-1 through 3-4. Bell Atlantic also computed the API value for each basket at the proposed, in this filing, to take effect July 2, 1992 rate levels, applying the formula specified in Section 61.46 of the Commission's Rules. Results of the API computations are also displayed on Figures 3-1 through 3-4. As shown in these figures, with the rate revisions proposed in this filing, the API value for each basket is equal to or less than the applicable PCI, in accordance with Section 61.49 (b) of the Commission's Rules.

Using the formula prescribed by the Commission in Section 61.47, Bell Atlantic also computed the SBIs for each band in the Switched and Special Access baskets.^{13/} The values for these indices are shown

13. Price Cap Order, ¶ 202.

in Figures 3-5 and 3-6. These figures also display the upper and lower band limitations established by the Commission for rate changes in those service categories.^{14/} All SBIs are within permitted levels.

Details associated with the API and SBI index computations can be found on Workpapers 6-7 through 6-9.

14. See Price Cap Order, ¶¶ 203-205; 47 C.F.R. Section 61.47 (h).

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FIGURE 3.

SUMMARY OF RESULTS
COMMON LINE BASKET

	(1) PCI(t)	SBI(t)	API(t)
Common Line	94.4398	N/A	N/A

Note : (1) WP 6-1, L10

SUMMARY OF RESULTS
SWITCHED ACCESS BASKET

	(1) PCI(t)	(2) SBI(t)	(3) API(t)
Switched	98.6015	N/A	97.0538
Switching	N/A	101.4385	N/A
Transport	N/A	93.6714	N/A
Information	N/A	99.9425	N/A

NOTES: (1) WORKPAPER 6-2
(2) WORKPAPER 6-7, COLUMN G
(3) WORKPAPER 6-7, COLUMN J

SUMMARY OF RESULTS
SPECIAL ACCESS BASKET

	(1) PCI(t)	(2) SBI(t)	(3) API(t)
Special Access	99.7448	N/A	98.1437
VG/WATS/Met/Tgh	N/A	102.9289	N/A
Audio/Video	N/A	101.5200	N/A
HiCap/DDS	N/A	93.4579	N/A
DS1 SubIndex	N/A	91.7258	N/A
DS3 SubIndex	N/A	89.5342	N/A
Wideband	N/A	102.4300	N/A

NOTES: (1) WORKPAPER 6-3, L9
(2) WORKPAPER 6-8, COL H, COLUMN J FOR SUBINDICES
(3) WORKPAPER 6-8, COLUMN F

SUMMARY OF RESULTS
INTEREXCHANGE SERVICES BASKET

	(1) PCI(t)	SBI(t)	(2) API(t)
Interexchange	101.2873	N/A	100.2335

NOTE (1): WORKPAPER 6-4, L11

NOTE (2): WORKPAPER 6-9, COL G

SBI VALUES
SWITCHED ACCESS BASKET

	(1) as of 6-30-91	(2) as of 7-2-92	(3) Lower Band Limit	(3) Upper Band Limit
Switching	98.3100	101.4385	93.6714	103.5315
Transport	98.3100	93.6714	93.6714	103.5315
Information	98.2800	99.9425	93.6428	103.5000

NOTES: (1) TRANSMITTAL 394, FIGURE 2-2 COLUMN 2

(2) WORKPAPER 6-7, COLUMN G

(3) WORKPAPER 6-10 TO 6-12

SBI VALUES

SPECIAL ACCESS BASKET

	(1) as of 6-30-91	(2) as of 7-2-92	(3) Lower Band Limit	(3) Upper Band Limit
VG/WATS/Met/Tgh	100.00	102.9289	96.5534	106.7169
Audio/Video	100.00	101.5200	96.5534	106.7169
HiCap/DDS	95.80	93.4579	92.4982	102.2348
DS1 SubIndex	95.00	91.7258	91.7258	101.3811
DS3 SubIndex	92.73	89.5342	89.5340	98.9586
Wideband	100.00	102.4300	96.5534	106.7169

NOTES: (1) TRANSMITTAL 394, FIGURE 2-3 COLUMN 2
 (2) WORKPAPER 6-8, COLUMN H, COLUMN J FOR SUBINDICES
 (3) WORKPAPER 6-13 TO 6-18

TAB INDICATOR SHEET

THIS INDICATOR SHEET MAY
BE USED IN PLACE OF YOUR
TABS AND TO INDICATE THE
SEPARATION OF DIFFERENT
SEGMENTS OF YOUR JOB.

TAB
NO. 4

SECTION 4

EXOGENOUS COST CHANGES

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SECTION 4

EXOGENOUS COST CHANGES

4.1 INTRODUCTION

Implementation of SFAS 106 as referred in the Commission's SFAS Order has caused a change in Bell Atlantic's costs. To determine the amount of the incremental exogenous costs that need to be recovered in its interstate rates, Bell Atlantic used the following methods of quantification. First, an eleven (11) step process was used to calculate applicable interstate incremental exogenous costs for 1991 and 1992. Second, using the results of the Godwins Study, a method was developed to account for the impact of SFAS 106 on GNP-PI. Third, the results of these two sets of calculations were used to determine the appropriate incremental exogenous costs for ratemaking purposes for each affected calendar period. The final process distributed the resulting incremental costs to the appropriate Price Cap baskets. The following Sections describe each of these processes and calculations.

4.2 INCREMENTAL EXOGENOUS COSTS

Because it recognized SFAS 106 effective January 1, 1991, Bell Atlantic needed to determine the appropriate incremental SFAS 106 exogenous costs for the 1991 and 1992 periods. An eleven step process was applied to the costs for each of these years, as follows:

Step One - Starting with total company annual SFAS 106 costs for the two years, the former "Pay-As-You-Go" and "Previously Recognized Amounts" were deducted from the new SFAS 106 amounts to arrive at basic Incremental Costs for SFAS 106. These computations can be found on Workpapers 6-20 and 6-31.

Step Two - These basic Incremental Costs were then split into expense and capital components, as shown on Workpapers 6-21 and 6-32. Since the overwhelming majority of SFAS 106 costs are expense related, a Bell Atlantic aggregate expense ratio was developed and utilized to quantify the small portion of SFAS 106 costs that are classified as capital.

Step Three - Using the Incremental Expense component derived in Step Two, the Incremental Expenses Subject to Separations were next calculated. To determine the

appropriate expenses subject to separations, factors were computed based on Bell Atlantic's Third Quarter 1991 ARMIS Reports. First, total company expenses less depreciation were calculated by subtracting depreciation/amortization from operating expenses. Next, the same calculations were performed for total company operating expenses subject to separations and depreciation/amortization subject to separations to arrive at total expenses less depreciation subject to separations. By dividing total company expenses less depreciation subject to separations by total company expenses less depreciation for each Bell Atlantic company, the appropriate factors were developed. These factors, in turn, were multiplied by the Incremental Expense component from Step Two to arrive at Incremental Expenses Subject to Separations. See Workpapers 6-22 and 6-33 for these computations.

Step Four - Using the Incremental Capital component developed in Step Two, Bell Atlantic next determined the incremental capital subject to separations. Again using Third Quarter 1991 ARMIS Reports, Bell Atlantic determined the applicable subject to separations factor for each company by dividing total company total plant in service (TPIS) by TPIS subject to separations. These factors were then multiplied by

the incremental capital amounts from Step Two to compute the Incremental Capital Subject to Separations. Workpapers 6-23 and 6-34 contain these calculations.

Step Five - Using the Incremental Expenses Subject to Separations, the next step was to determine the interstate amounts for each company. As shown on Workpapers 6-24 and 6-35, interstate factors were computed based on Bell Atlantic's Third Quarter 1991 ARMIS Reports. To compute these factors, it was necessary to determine the relationship between total company expenses less depreciation subject to separations versus interstate total expenses less depreciation. The factors resulting from this relationship were then multiplied by the incremental expenses subject to separations that were developed in Step Three to arrive at Interstate Incremental Expenses.

Step Six - The Incremental Capital Subject to Separations component also needed to be translated into an interstate amount. Using the same basic approach as in Step Five, interstate factors were computed (based on total company TPIS subject to separations and Interstate TPIS). The interstate

factors were then multiplied by the incremental capital subject to separations to determine the Interstate Capital amounts. These amounts were then expressed on a mid-year basis for use in later computations, as shown in Workpapers 6-25 and 6-36.

Step Seven - Based on the interstate capital amounts derived in Step Six, Bell Atlantic next computed the Incremental Depreciation Expenses associated with the incremental interstate Capital amounts for each company. The depreciation rate was determined by dividing annualized depreciation/amortization interstate amounts by Interstate TPIS. Applying the derived depreciation rate against the incremental capital interstate amounts determined the Incremental Depreciation Expenses. These computations are shown on Workpapers 6-26 and 6-37.

Step Eight - Bell Atlantic next computed the individual state deferred taxes and average deferred tax balances in Workpapers 6-27 and 6-38. It was necessary first to add the incremental interstate expenses from Step Five to the incremental interstate depreciation expenses from Step Six to arrive at the total interstate expenses not recognized for tax purposes. The applicable state tax rates were then

multiplied by the total interstate expenses not recognized for tax purposes to determine State Deferred Taxes. These amounts were divided by two to arrive at the Average Deferred Tax Balance.

Step Nine - Bell Atlantic next determined Average Deferred Tax Balance for federal income taxes (FIT). This required adding incremental interstate expenses (Step Five) to incremental interstate depreciation expense (Step Six) and subtracting state income taxes not recognized for tax purposes (Step Eight) to arrive at total interstate expenses not recognized for tax purposes. By multiplying the results of these computations by the applicable FIT rate of 34%, FIT deferred taxes were computed. Dividing FIT deferred taxes by two produced the Average Deferred Tax Balance, as shown on Workpapers 6-28 and 6-39.

Step Ten - This step determined the amount of Unfunded Liability Assigned to Interstate for use in the net rate base calculations ^{15/} in the final step.

15. Part 65 of the Commission's Rules does not reduce the rate base for the unfunded liability. However, since Bell Atlantic is proposing recovery of the expense, Bell Atlantic suggests that the rate base should be reduced for the unfunded liability.

Workpapers 6-29 and 6-40 contain the necessary calculations to arrive at these amounts for each Bell Atlantic company. The methodology used was to apply the appropriate interstate factor against the total company incremental (unfunded) costs developed in Step One to arrive at the interstate amounts. Bell Atlantic's Third Quarter 1991 ARMIS Reports were used as source material. In this case, total interstate expenses less depreciation for each company were computed by subtracting ARMIS interstate depreciation/amortization amounts from total operating expenses interstate. The results of these calculations were then divided by total company expenses less depreciation, (again based on ARMIS sources) to produce the Interstate factors.

Step Eleven - The final step in developing the appropriate SFAS 106 Incremental Exogenous Costs was to develop the Incremental Interstate Revenue Requirement, which was done on Workpapers 6-30 and 6-41. The annual interstate revenue requirements for each year were calculated and provided the annual amounts for determining the exogenous cost amounts for ratemaking, as described in Section 4.4, following.

4.3 GNP-PI Impact

The Godwins Study Actuarial Analysis was performed in two steps. First, Godwins collected demographic, economic, and benefit program data from Price Cap LECs. Using the data, Godwins developed a composite company that reflected the characteristics and benefit plans of the average Price Cap LEC. From this data, Godwins calculated the average Price Cap LEC Benefit Level Indicator (BLI). This indicator represents the percentage of total medical claims incurred by employers' retirees that will be reimbursed by the employers' benefit programs.

Second, Godwins calculated a BLI for the GNP. Godwins utilized a data base of over 1,000 employers. The employers in the data base were compared to the employers who make up GNP, utilizing published and unpublished data from the United States General Accounting Office. Using this data, along with the data in Step 1, Godwins determined that, even assuming all additional SFAS 106 costs are passed completely into the GNP-PI, the average company in the United States will experience only 28.3 % of the SFAS 106 cost burden of the average Price Cap LEC. This demonstrates that the mandated implementation of

SFAS 106 will have a disproportionate effect on Bell Atlantic

The Macroeconomic Analysis utilized a macroeconomic model that has two sectors. In sector 1, employers do not offer postretirement health benefits, and in sector 2, employers do offer postretirement health benefits. The model treated the introduction of SFAS 106 as a direct increase in the costs of labor facing employers in sector 2.

The results of this model determined that SFAS 106 will ultimately increase the GNP-PI by .0124%. The Godwins' Study concluded that, on average, .7% of the Price Cap LECs SFAS 106 costs will eventually be recovered by the LECs through the GNP-PI factor in Price Caps.

In addition to the GNP-PI impact, the model also indicated that there will be other macroeconomic impacts. The major other impact is the effect on the wage rate in the national economy. The model forecasts that, in response to the impact of SFAS 106, wage rates in the national economy will, over time, fall relative to what they would have been in the absence of SFAS 106. To the extent that Price Cap companies could also benefit from a relative suppression in their wage rates, this would help

offset their increases in costs due to SFAS 106.

If Price Cap companies were able to achieve the full reduction, it might offset 14.5% of their additional SFAS 106 costs. This wage suppression reflects the ultimate effect of SFAS 106 and would not occur in the first year.

4.4 Incremental Exogenous Costs for Ratemaking

As stated in Section 1 of this filing, there are three periods for which exogenous costs must be calculated:

1. January 1, 1991 through June 30, 1991,
2. July 1, 1991 through June 30, 1992
3. July 1, 1992 through June 30, 1993.

The First Period (January 1, 1991 — June 30, 1991)

Bell Atlantic adopted SFAS 106 effective January 1, 1991. This means that Bell Atlantic has realized the costs of going from a cash basis to an accrual basis of accounting for such benefits starting from that

date. Effective January 1, 1991, the Commission adopted incentive based regulation to replace existing Rate of Return (ROR) regulation.^{16/} Bell Atlantic was required to retarget its for the period from January 1, 1991 through June 30, 1991, based on Rate of Return principles and without any allowance for changes in the GNP-PI. Since the rates from January 1, 1991 through June 30, 1991, did not include any SFAS 106 costs, Bell Atlantic proposes to include the entire incremental costs of SFAS 106 for that period as exogenous. Because GNP-PI was not used in the approved rates from January 1, 1991 through June 30, 1991, the exogenous amount would not be double counted in the GNP-PI. Therefore, the total Interstate incremental cost change of \$9.7M is treated as exogenous. See Workpaper 6-43. Bell Atlantic proposes that then such exogenous costs would be reflected in rates effective from July 2, 1992 until June 30, 1993. After that time, Bell Atlantic will remove these exogenous amounts for the 1993 Annual Filing.

16. Policy and Rules Concerning Rates for Dominant Carriers, CC Docket 87-313, Report and Order, FCC 90-314, released October 4, 1990 ("Price Cap Order")

The Second Period (July 1, 1991 — June 30, 1992)

Since the rates in effect from July 1, 1991 through June 30, 1992 did not include any costs for SFAS 106, Bell Atlantic proposes to include the incremental costs of SFAS 106 as exogenous. The exogenous cost amount of \$20.1M was calculated by adding half the 1991 incremental cost amount and half of the 1992 incremental cost amount. See Workpaper 6-43. Bell Atlantic then analyzed the GNP-PI used to develop rates for the period July 1, 1991 through June 30, 1992. The Commission requires that Carriers use the GNP-PI Published by the United States Department of Commerce, 45 day estimate. This GNP-PI reflected the percentage change in the GNP-PI from the fourth quarter 1990 versus the fourth quarter 1989.^{17/}

FASB issued SFAS 106 in December 1990. Therefore, neither the fourth quarter 1990 nor the fourth quarter 1989 could have realized any costs associated with SFAS 106. Since the GNP-PI, used for rates in effect

17. Bell Atlantic Transmittal No. 436, 1991 Annual Price Cap Filing, issued May 2, 1991.

from July 1, 1991 through June 30, 1992, was not impacted by any costs for SFAS 106 the total incremental amount developed on Workpaper 6-43 was considered exogenous for this period.

Bell Atlantic proposes that there costs be recovered in rates to be effective from July 2, 1992 until June 30, 1993. After that time, Bell Atlantic will remove these exogenous amounts for the 1993 Annual Filing.

The Third Period (July 2, 1993 — June 30, 1993)

Since the rates in effect from July 1, 1991 through June 30, 1992, did not include any costs for SFAS 106, Bell Atlantic proposes to include the incremental costs of SFAS 106 as exogenous. The exogenous cost amount was calculated by determining the amounts that should have been included in rates from July 1, 1991 through June 30, 1992. This amount was then reduced by the GNP-PI impact.

The GNP-PI impact was calculated by using the .0124%, factor determined in the Godwins Study, multiplied by Interstate revenues less End User revenues. See Workpaper 6-42. End User revenues were subtracted because they are not affected by the GNP-PI. End User

rates are still determined by forecasting a revenue requirement and then dividing the revenue requirement by its forecasted demand.

This resulting amount (.0124% multiplied by Interstate revenues less End User revenues) represents the amount Bell Atlantic is expected to recover through GNP-PI for SFAS 106. This amount was then subtracted from the amount that should have been included in rates in effect from July 1, 1991 through June 30, 1992. See Workpaper 6-43. This amount, net of GNP-PI impact, also represents the exogenous cost amount that should be included in rates after June 30, 1992 on a going forward basis and thus should be included in the rate development for future annual filings.

4.5 DISTRIBUTION OF EXOGENOUS COST CHANGES

The Commission's Rules direct Price Cap LECs to distribute exogenous cost changes among the baskets on a cost causative basis.^{18/} Bell Atlantic distributed the exogenous cost changes for these SFAS 106 changes

18. 47 C.F.R., Section 61.45 (d) (4).